

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Cedillo, et al Analyst: Jeff Garnier Bill Number: AB 1107

Related Bills: See Leg. History Telephone: 845-5322 Amended Date: 6-15-99

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Conformity to Self-Employed Health Insurance Deduction

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would provide that for taxable years beginning on or after January 1, 1999, California law would conform to federal law with regard to the incremental phase-in of a 100% deduction for self-employed health insurance costs.

This bill also would make numerous other changes including changes to the Business and Professions Code, the Government Code, the Health and Safety Code, and the Welfare Institutions Code. This analysis only addresses the provision of the bill, full conformity to the self-employed health insurance deduction, that impacts the operation of the Franchise Tax Board.

SUMMARY OF AMENDMENT

The bill as originally introduced on February 25, 1999, declared it was the intent of the legislature to make necessary statutory changes to implement the Budget Act of 1999 relative to funding of the Department of Fish & Game.

The amendment removed the intent language and substituted the provisions as outlined under "Summary of Bill."

EFFECTIVE DATE

The self-employed health insurance provisions of this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Existing federal law provides for a deduction in determining adjusted gross income (AGI) of 60% (effective for 1999) of a self-employed individual's cost for health insurance. Federal law also allows the deductible percentage to increase incrementally to 100% beginning in the year 2003. The percentage is increased as follows:

1999 through 2001	60%
2002	70%
2003 and thereafter	100%

Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald Goldberg

6/24/1999

California law provides for a deduction of 40% of a self-employed individual's cost for health insurance in determining AGI.

Under both **federal and state law**, "health insurance costs" include premiums paid for health insurance of the taxpayer, the taxpayer's spouse, and dependents. Certain qualified "long term care premiums" also are considered health insurance costs for this purpose.

Additionally, under both **federal and state law**, a deduction for health insurance for self-employed individuals is not allowed from gross income if the individual or individual's spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual's spouse.

The deduction from gross income is limited to the extent of the individual's federal earned income from the business from which the health coverage was established.

Finally, under both **federal and state law**, the cost of health insurance incurred by a self-employed individual that is not deductible in determining AGI may be taken as an itemized medical deduction. Itemized medical deductions are limited to the amount that exceeds 7.5% of the taxpayer's AGI. All individuals may deduct health insurance costs paid by the individual as an itemized medical deduction subject to the 7.5% AGI floor.

This bill would conform California law to federal law with regard to the incremental phase-in of a 100% deduction for self-employed health insurance costs.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's cost.

Tax Revenue Estimate

The revenue losses from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Impact Effective 1/1/99 Enacted Assumed After 6/30/99 \$ Millions				
1999-00	2000-01	2001-02	2002-03	2003-04
\$ (21)	\$ (19)	\$ (25)	\$ (49)	\$ (83)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this provision will be determined by the number of self-employed individuals who claim additional insurance deductions, and the average marginal tax rate applicable to the deduction amounts.

This estimate was developed in the following steps. First, the number of California resident taxpayers who currently claim the self-employed insurance deduction was calculated from returns filed for 1995 (425,000). Secondly, the deduction amount for that year of 25% was calculated to be \$839 on average for returns filed in 1995, making the average annual health insurance premium \$3,356 (\$839 x 4). Third, the estimated number of qualified taxpayers for 1995 was grown at 5% per year to yield 517,000 qualified taxpayers for 1999. Fourth, the insurance premium was grown at 7% per year to yield an average \$4,399 insurance premium for 1999. Fifth, the total deduction at 40% was calculated to be \$910 million for 1999 (\$41 million tax loss), and the amount deducted for health insurance premiums on Schedule-A was calculated to be \$326 million (\$14 million tax loss), generating a total deduction amount under current law of \$1,236 million (\$55 million tax loss). At an average marginal tax rate of 4.5% (computed by the PIT microsimulation model for self-employed individuals), the current law revenue loss for 1999 is \$55 million. Sixth, the total deduction was calculated at 60% at a 4.5% marginal tax rate for 1999, generating a \$61 million tax loss, and the amount deducted for health insurance premiums on Schedule-A was calculated to be \$10 million, generating a total \$71 million tax loss. These steps resulted in a 1999 liability year estimate of an additional \$16 million tax loss. Losses for all years were calculated using the above method and were grown to reflect a combined annual growth of 5% (qualified taxpayers) and 7% (premiums) based on current historical averages.

BOARD POSITION

Pending.